

HYDRO ONE INC. MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

As used in this section, references to increases and decreases, whether in terms of amounts or percentages are made by comparison of the three and nine months ended September 30, 2007 to the three and nine months ended September 30, 2006.

Revenues

	Three months ended September 30				Nine months ended September 30			
			\$	%			\$	%
(Canadian dollars in millions)	2007	2006	Change	Change	2007	2006	Change	Change
Transmission	307	331	(24)	(7)	949	945	4	-
Distribution	813	828	(15)	(2)	2,555	2,441	114	5
Other	8	6	2	33	22	17	5	29
	1,128	1,165	(37)	(3)	3,526	3,403	123	4
Average Ontario 60-minute peak demand (MW) ¹	24,730	24,358	372	2	23,542	23,112	430	2
Distribution - units distributed to customers (TWh) ¹	7.1	7.0	0.1	1	22.5	21.6	0.9	4

¹System-related statistics are preliminary

The demand for electricity generally follows normal weather-related variations, and, therefore, our energy-related revenues, all other things being equal, will tend to be higher in the first and third quarters than in the second and fourth quarters.

Transmission

Transmission revenues predominantly consist of our transmission tariff, which is based on the monthly peak demand for electricity across our high-voltage network. The tariff is designed to recover revenues necessary to support a transmission system with sufficient capacity to accommodate the maximum expected demand, which is primarily influenced by weather and economic conditions. Transmission revenues also include minor amounts of ancillary revenues, which are primarily attributable to maintenance services provided to generators, and secondary use of our land rights-of-way.

Revenues for the quarter and for the year-to-date periods were affected by the Ontario Energy Board's (OEB's) August 16, 2007 decision on our transmission rate application. The OEB approved all of our work program expenditure requirements. Our return on equity was reduced from 9.88% to 8.35% and our deemed capital structure was adjusted from one that included common and preferred shares and debt to a deemed capital structure split of 60% debt and 40% common shares. This capital structure is consistent with that approved by the OEB in its December 2006 report which established the capital structure for Ontario's electricity distributors. The OEB's decision was effective January 1, 2007 and new customer rates reflecting the decision were implemented on November 1, 2007. As a result of the OEB decision, we reduced our 2007 transmission revenues in the third quarter to reflect the approved revenue requirement. These amounts are being returned to customers through lower rates commencing November 1, 2007. This liability has been recorded in the Revenue Difference Deferral Account (RDDA). On March 30, 2007, the OEB approved cessation of the 2006 transmission Earnings Sharing Mechanism (ESM) effective December 31, 2006 and replaced it with the RDDA. The RDDA liability will be drawn down over the period the new rates are in place and revenue will be recorded based on the approved revenue requirement throughout the remainder of 2007 and during 2008.

Our transmission tariff revenues decreased by \$24 million, or 7%, during the third quarter of 2007, but increased by \$4 million in the first nine months compared to the same period last year. Our transmission revenues reflect the impacts of the OEB's August 16, 2007 transmission rate decision, which had the effect of reducing our quarterly and year-to-date revenues by about \$38 million. This reduction includes the revenue adjustment associated with recording the RDDA liability, as well as other decision-related revenue adjustments related to the disposition of regulatory asset and liability accounts and the recording of export and wheeling fees revenue. In addition, our transmission revenues were higher than the comparative periods by \$6 million in the quarter and \$23 million year-to-date as a result of the OEB's earlier decision to end the ESM effective December 31, 2006.

HYDRO ONE INC. MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Revenues for the third quarter and year-to-date also reflect higher average peak demands compared to the same periods last year, resulting in increased transmission revenues of \$5 million in the quarter and \$21 million for the year-to-date period. We also experienced increased other revenues of \$3 million in the quarter and decreased other revenues of \$2 million on a year-to-date basis.

Distribution

Distribution revenues include our distribution tariff, which is based on OEB-approved rates, as well as amounts to recover the cost of purchased power used by our customers. Accordingly, distribution revenues are primarily influenced by our distribution rates, the amount of electricity we distribute, and the cost of purchased power. Distribution revenues also include a minor amount of ancillary distribution services revenue, such as fees related to the use of our poles by the telecommunications and cable television industries, and miscellaneous charges such as those for late payments.

Distribution revenues decreased by \$15 million, or 2%, to \$813 million in the third quarter but increased by \$114 million, or 5%, to \$2,555 million during the first nine months compared to the same periods last year. These changes include the recovery of lower purchased power costs of \$31 million in the quarter and higher purchased power costs of \$29 million in the first nine months, as described below under "Purchased Power." In addition, the OEB approved increases in distribution tariff rates for our subsidiaries, Hydro One Networks Inc. (Hydro One Networks) and Hydro One Brampton Networks Inc. (Hydro One Brampton Networks), effective May 1, 2006 and May 1, 2007 respectively. These tariff rate increases, which support the maintenance and investment requirements of our distribution system, enabling the safe and reliable delivery of electricity to our customers throughout Ontario, resulted in higher distribution revenues of \$1 million in the quarter and \$44 million in the first nine months. In 2006, rates were based on a full cost of service hearing and in 2007, rates were adjusted based on OEB guidelines. Higher energy consumption, resulting primarily from the colder winter weather this year, increased our distribution revenues by a further \$4 million in the quarter and \$18 million in the year-to-date period. In addition, as a result of the OEB's decision on August 8, 2007 regarding the combined smart meter proceeding, we recorded smart meter revenues of \$6 million in the quarter and \$16 million in the first nine months. We also experienced higher other revenues of \$5 million in the quarter and \$7 million in the first nine months of 2007 compared to the same periods last year.

Purchased Power

Purchased power costs incurred by our distribution business represent the cost of electricity delivered to customers within our distribution service territory and consist of the wholesale commodity cost of energy, the Independent Electricity System Operator's (IESO's) wholesale market service charges, and transmission charges levied by the IESO. The commodity cost of energy for certain low-volume and designated customers is based on the OEB's Regulated Price Plan (RPP), which consists of a two-tiered pricing structure with threshold amounts adjusted twice annually. Customers who are not eligible for the RPP pay the market price for electricity, adjusted for the difference between market prices and the prices paid to generators under the *Electricity Restructuring Act, 2004*. A summary of the RPP is provided below.

Effective Date	Summary of RPP			
	Tier Threshold (kWh)		Tier Rates (cents/kWh)	
	Residential	Non-Residential	First Tier	Second Tier
November 1, 2005	1,000	750	5.0	5.8
May 1, 2006	600	750	5.8	6.7
November 1, 2006	1,000	750	5.5	6.4
May 1, 2007	600	750	5.3	6.2

Purchased power costs decreased by \$31 million, or 5%, to \$533 million in the third quarter but increased by \$29 million, or 2%, to \$1,696 million during the first nine months compared to the last year. The decrease for the quarter primarily reflects the impact of the May 1, 2007 reduction in RPP rates for residential and other eligible customers of \$36 million, partially offset by higher wholesale commodity prices for customers who are not eligible for the RPP of \$2 million, higher demand for electricity of \$2 million, and higher wholesale market service charges levied by the IESO of \$1 million. For the nine-month period, higher demand for electricity of \$49 million, higher wholesale commodity prices for customers who are not eligible for the RPP of \$12 million, and higher wholesale market service charges levied by the IESO of \$3 million, more than offset the impact of the May 1, 2007 RPP rate change for residential and other eligible customers of \$35 million.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Operation, Maintenance and Administration

Our operation, maintenance and administration costs are comprised primarily of labour, material, equipment and purchased services in support of the operation and maintenance of the transmission and distribution systems. These costs also include property taxes and payments in lieu thereof on our transmission and distribution lines, stations and buildings.

Operation, maintenance and administration costs for each of our three business segments were as follows:

	Three months ended September 30				Nine months ended September 30			
			\$	%			\$	%
(Canadian dollars in millions)	2007	2006	Change	Change	2007	2006	Change	Change
Transmission	117	105	12	11	323	307	16	5
Distribution	137	122	15	12	410	328	82	25
Other	9	6	3	50	23	17	6	35
	263	233	30	13	756	652	104	16

Transmission

Operation, maintenance and administration expenditures incurred to sustain our high-voltage transmission stations, lines and rights-of-way increased by \$12 million, or by 11%, in the quarter and increased by \$16 million, or 5%, on a year-to-date basis compared to the same periods last year. Within our work programs, we continued our investments that support the safe and reliable operation of the transmission system. We experienced higher work program expenditures of approximately \$13 million in the quarter and about \$24 million year-to-date, primarily due to the enhancement of our planned station maintenance program. Higher expenditures on line clearing and brush control were experienced in the quarter. In addition, we experienced a one-time \$6 million cost related to revaluing some of our transmission regulatory accounts as a result of the OEB's August 16, 2007 transmission rate decision. Our expenditures incurred in support of the transmission system increased marginally during the first nine months as we commenced a major business systems and processes project. The impact of these increases was offset by the impact of reassigning resources to support our larger transmission capital program.

Distribution

Operation, maintenance and administration expenditures necessary to maintain our low-voltage system increased by \$15 million, or 12%, in the third quarter and by \$82 million, or 25%, on a year-to-date basis, relative to the comparative periods. Higher expenditures within our work program of \$8 million in the quarter and \$51 million for the first nine months resulted from higher line clearing expenditures and customer participation in our conservation and demand management programs. These impacts were partially offset in the quarter by a reduction in our lines maintenance work program, predominantly as a result of higher storm activity in 2006. In addition, pension costs within our distribution business for the quarterly and year-to-date periods were higher than in 2006 as a result of last year's OEB rate decision. Prior to May 1, 2006, all of our distribution-related pension costs were deferred as a regulatory asset. As a result of the OEB's August 8, 2007 decision on the combined smart meter proceeding, we have recorded increased operation, maintenance and administration expense related to smart meter expenditures incurred in the 2005 to 2007 period that were previously deferred as regulatory assets. In addition to these increases, our other support expenditures for the first nine months increased marginally as a result of the commencement of a major business systems and processes project.

Depreciation and Amortization

Depreciation and amortization decreased by \$4 million, or 3%, to \$128 million in the third quarter and increased by \$5 million, or 1%, to \$382 million in the first nine months compared to the same periods last year. The reduction in the quarter is primarily due to lower amortization of regulatory assets of \$3 million. The remainder of the reduction in the quarter is due to lower fixed asset removal costs resulting from lower storm damage. The year-to-date increase is primarily due to higher year-over-year amortization of our regulatory assets of \$2 million resulting from an April 12, 2006 OEB distribution rate decision that was effective on May 1, 2006, combined with higher fixed asset removal costs of \$2 million as a result of increased storm work performed in the first and second quarters.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Financing Charges

Financing charges increased by \$2 million, or 3%, to \$76 million in the quarter and by \$3 million, or 1%, to \$223 million in the first nine months of the year, compared to the same periods last year. These increases were primarily due to reduced capitalization of financing costs of \$4 million in the quarter and \$10 million for the first nine months. Interest capitalization on our fixed and regulatory assets was lower as a result of lower OEB-prescribed rates and higher net regulatory liability balances resulting from recording the RDDA. Interest related to a first quarter 2006 recovery of payments in lieu of corporate income taxes also contributed to the increase in year-over-year financing costs for the nine month period. The impact of these increases was partially offset by lower interest on long-term debt of about \$2 million in the quarter and \$9 million for the first nine months, reflecting the impact of lower average borrowing costs partially offset by a higher average level of debt outstanding.

Provision for Payments in Lieu of Corporate Income Taxes

The provision for payments in lieu of corporate income taxes increased by \$2 million, or 3%, to \$61 million in the third quarter and by \$27 million, or 20%, to \$160 million on a year-to-date basis compared to last year. The year-to-date increase primarily reflects last year's first quarter recognition of a \$30 million tax benefit related to the recovery of payments in lieu of corporate taxes from prior years. These impacts were partially offset by higher capital cost allowance in excess of depreciation this year and other temporary differences.

Net Income

Net income of \$67 million was lower by \$36 million, or 35%, in the third quarter and was lower by \$45 million, or 13%, in the first nine months compared to 2006 results. Net income, both in the quarter and year-to-date, was impacted by the OEB's August 16, 2007 transmission rate decision. While the OEB approved all of our work program requirements for 2007 and 2008, our return on equity was reduced from 9.88% to 8.35%. Our net income levels in both the quarterly and year-to-date periods were also affected by higher distribution work program expenditures to maintain system reliability, the impact of a 2006 OEB decision on our distribution-related pension expenditures and by higher effective tax rates. The increased rates are related to temporary differences associated with amounts to be returned to customers as part of the OEB's transmission rate decision and a recovery of payments in lieu of corporate income taxes in the first quarter of last year. These impacts were partially offset by increased transmission revenues due to a higher average peak demand and distribution tariff revenues for the first nine months of 2007.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth unaudited quarterly information for each of the eight quarters from December 31, 2005 through September 30, 2007. This information has been derived from our unaudited interim Consolidated Financial Statements which, in the opinion of our management, have been prepared on a basis consistent with the audited annual Consolidated Financial Statements and which include all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of our financial position and results of operations for those periods. These operating results are not necessarily indicative of results for any future period and should not be relied upon to predict our future performance.

(Canadian dollars in millions)	2007				2006			2005
	Sep. 30	Jun. 30	Mar. 31	Dec. 31	Sep. 30	Jun. 30	Mar. 31	Dec. 31
Quarter ended								
Total revenue ^{1, 2, 3}	1,128	1,120	1,278	1,142	1,165	1,078	1,160	1,025
Net income ^{1, 2, 3}	67	93	149	101	103	99	152	104
Net income to common shareholder ^{1, 2, 3}	63	88	145	96	99	94	148	99

¹ The demand for electricity generally follows normal weather-related variations, and therefore our electricity-related revenues and profit, all other things being equal, would tend to be higher in the first and third quarters than in the second and fourth quarters.

² Under a new regulation issued in October 2005, RPP customers received a one-time credit reflecting a lower cost of power than the fixed commodity price between April 1, 2004 and March 31, 2005. In the fourth quarter of 2005, revenue and cost of power were both reduced by approximately \$140 million. The application of the one-time credit did not result in any adjustment to net income.

³ As a result of the OEB's August 16, 2007 decision on Hydro One Networks' Transmission rate application that was effective January 1, 2007, year-to-date revenues have been adjusted to reflect a reduced revenue requirement based on the approved rate of return of 8.35%.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity and capital resources are funds generated from operations, debt capital market borrowings and bank financing. These resources will be used to satisfy our capital resource requirements, which continue to include capital expenditures, servicing and repayment of our debt, payments related to our outsourcing arrangements, investing activities, and dividends.

Summary of Sources and Uses of Cash <i>(Canadian dollars in millions)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Operating activities	331	351	868	715
Financing activities				
Long-term debt issued	-	150	400	700
Long-term debt retired	(73)	-	(355)	(448)
Short-term notes payable	85	(130)	100	-
Dividends paid	(72)	(63)	(252)	(286)
Investing activities				
Capital expenditures	(275)	(218)	(765)	(593)
Other financing and investing activities	4	4	18	9
Net change in cash and cash equivalents	-	94	14	97

Operating Activities

Net cash generated from operating activities decreased by \$20 million to \$331 million in the third quarter, but increased by \$153 million to \$868 million in the first nine months. The decrease for the quarter was primarily due to marginally higher working capital requirements compared to the third quarter last year. Our working capital requirements in the year-to-date period were substantially lower than the comparative period primarily as a result of a first quarter 2006 recovery of payments in lieu of corporate income taxes and the impact of the *Ontario Price Credit* that was provided to RPP customers in early 2006, pursuant to regulation. Funding for the credit was received from the IESO in early December 2005.

Financing Activities

Short-term liquidity is provided through funds from operations and our Commercial Paper Program, under which we are authorized to issue up to \$1 billion in short-term notes with a term to maturity of less than 365 days. As at September 30, 2007, we had \$161 million of short-term notes payable. The Commercial Paper Program is supported by a \$750 million committed revolving credit facility with a syndicate of banks which matures on August 10, 2010. The short-term liquidity under this program and anticipated levels of funds from operations should be sufficient to fund our normal operating requirements. Long-term financing is provided by our access to the debt markets, primarily through our Medium-Term Note Program. On June 21, 2007, we filed a \$2.5 billion base shelf prospectus to renew our Medium-Term Note Program for another 25 months. Our notes and debentures mature between 2007 and 2046. We currently plan to refinance maturing debt principally through our Medium-Term Note Program. The maximum authorized principal amount of medium-term notes issuable under this program is \$2,500 million, all of which currently remains available until July 2009.

Rating Agency	Rating	
	Short-term Debt	Long-term Debt
DBRS Inc.	R-1 (middle)	A (high)
Moody's Investors Service Inc.	Prime-1	Aa3
Standard & Poor's Rating Services Inc.	A-1	A

We have the customary covenants normally associated with long-term debt. Among other things, our long-term debt covenants limit our permissible debt as a percentage of our total capitalization, limit our ability to sell assets and impose a negative pledge provision, subject to customary exceptions. The credit agreement related to our \$750 million credit facility has no material adverse change clauses that could trigger default. However, the credit agreement requires that we provide notice to the lenders of any material adverse change within three business days of the occurrence. The agreement also provides limitations that debt cannot exceed 75% of total capitalization and that debt issued by our subsidiaries cannot exceed 10% of the total book value of our assets. We are in compliance with all of these covenants and limitations.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

During the third quarter of 2007, we repaid \$73 million in maturing long term debt and increased our short-term notes by \$86 million. During the same period in 2006, we issued \$150 million in long-term debt under our Medium-Term Note Program and decreased our short-term notes by \$130 million.

During the first nine months of 2007, we issued \$400 million in long-term debt under our Medium-Term Note Program, repaid \$355 million in maturing long-term debt, and increased our short-term notes by \$101 million. In comparison, during the same period in 2006, we issued \$700 million in long-term debt under our Medium Term Note Program and repaid \$448 million in maturing long-term debt.

In the third quarter of 2007, we paid dividends to the Province of Ontario in the amount of \$72 million, consisting of \$68 million in common dividends and \$4 million in preferred dividends. In the comparative period, we paid common dividends of \$59 million and preferred dividends of \$4 million. Year-to-date, we have paid common and preferred dividends totaling \$252 million, compared to \$286 million in 2006.

Common dividends are declared at the sole discretion of our Board of Directors, and are recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations. Common dividends pertaining to the quarterly financial results are generally declared and paid in the immediately following quarter.

Investing Activities

Cash used for investing activities primarily represents capital expenditures for each of our three business segments as follows:

(Canadian dollars in millions)	Three months ended September 30				Nine months ended September 30			
			\$	%			\$	%
	2007	2006	Change	Change	2007	2006	Change	Change
Transmission	144	93	51	55	394	290	104	36
Distribution	126	123	3	2	355	298	57	19
Other	5	2	3	150	16	5	11	220
	275	218	57	26	765	593	172	29

Transmission

Transmission capital expenditures increased by \$51 million, or 55%, to \$144 million in the third quarter, and increased by \$104 million, or 36%, to \$394 million in the first nine months, compared to the same periods in 2006. Expenditures made to expand and reinforce our transmission system were \$72 million in the quarter and \$208 million for the first nine months of the year, representing increases over the comparative periods of \$26 million and \$78 million, respectively. These increases primarily reflect expenditures on major lines and stations development projects. These expenditures have increased primarily as a result of our construction on a new inter-connection with Quebec, which will increase access to emission-free hydroelectric power, work on our Cambridge Preston Transformer Station and on our Essa to Stayner connection, and the continued construction of our Downtown Toronto Cable Project. The impact of these increases was partially offset by last year's expenditures on our Niagara Reinforcement Project. This project was substantially completed last year but final completion continues to be delayed by the aboriginal land dispute in the Caledonia area. Discussions continue between the affected aboriginal peoples and the various government entities involved. Expenditures on our load and generation connections work have also increased as a result of work at our London Talbot, Holland and Whitby transformer stations, as well as the reconfiguration of our Lambton Transformer Station. Expenditures to sustain our existing transmission system were \$55 million in the quarter and \$147 million on a year-to-date basis, representing increases of \$11 million and \$8 million respectively, compared to the same periods last year. Our other transmission capital expenditures increased to \$17 million and \$39 million for the three and nine month periods, compared to \$3 million and \$21 million in the same periods last year, primarily due to higher information technology expenditures, including expenditures on a major business systems and processes project.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Distribution

Distribution capital expenditures increased by \$3 million, or 2%, to \$126 million in the quarter and by \$57 million, or 19%, to \$355 million for the first nine months, compared to the same periods in 2006. Capital investments to expand and reinforce our distribution network were \$57 million in the quarter and \$166 million for the first nine months, representing increases of \$10 million and \$46 million, respectively over the comparable periods. These increases primarily reflect our ongoing investments in smart meters. During the quarter, we installed about 83,000 smart meters, for a year-to-date total of approximately 172,000 and a cumulative program total of approximately 200,000. We plan to install about 240,000 smart meters in 2007. Expenditures to sustain our distribution system were \$56 million in the quarter and \$152 million year-to-date, representing decreases of \$17 million and \$9 million, respectively compared to last year. These decreases were primarily due to reduced storm activity this year compared to the summer of 2006. This impact was partially offset by higher planned end-of-life asset component replacement expenditures in our lines work program this year. Our other distribution capital expenditures increased to \$13 million and \$37 million for the three and nine month periods, compared to \$3 million and \$17 million in the same periods last year primarily due to higher information technology expenditures, including expenditures on a major business systems and processes project.

Other

Other capital expenditures made to enhance our telecom infrastructure increased by \$3 million in the third quarter and by \$11 million in the first nine months compared to the same periods in 2006. These increases were largely due to construction of a dedicated optical network which will provide secure, high capacity connectivity across numerous healthcare locations in Ontario.

Future Capital Expenditures

Our capital expenditures are planned to be about \$1.2 billion in 2007 and \$1.4 billion in 2008. These planned investments will address new development and supply enhancement initiatives, including system expansions, generation requirements and load connections, and the needs of our aging transmission system under continued challenging conditions of generation supply. The OEB approved the transmission-related investments for both 2007 and 2008 in its decision of August 16, 2007. Within our distribution business, the mass deployment of smart meters is underway and we are currently on track to meet our 2007 year-end target. Our future capital expenditures also include a major business systems and processes project, which incorporates the replacement of end of life information systems.

The Ontario Power Authority (OPA) has completed its Integrated Power System Plan (IPSP), focusing primarily on the mid-to long-term time frames, and submitted it to the OEB at the end of August 2007. Consequently, we will be required to justify the need for many of our key projects. We have initiated section 92 leave-to-construct filings with the OEB for our pre-IPSP projects. No significant changes have been noted between the IPSP and our business plan, although the IPSP recommends commencement of project development work on certain large and immediate projects. The IPSP is a key driver for the amount of our future capital expenditures. The timing of many of our development projects is also dependent on the requirement to seek and attain approvals from various regulatory bodies, requirements for negotiations and consultations with customers, neighbouring utilities and other stakeholders, and our ability to effectively resource these projects. We will not undertake large capital expenditures without a reasonable expectation of recovering them in our rates.

Our distribution investment plan includes the mass rollout of the smart metering program. Over the period 2007 to 2010, we anticipate installing 1.3 million meters throughout our service territory. Consistent with the government policy, all homes and small businesses are to receive a smart meter by the end of 2010. Total project costs are anticipated to be significant. In 2007, we plan to invest approximately \$75 million under our smart meter program. At the Province's request, we will review our implementation plan and associated costs for the period 2008 to 2010.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Summary of Contractual Obligations and Other Commercial Commitments

The following table presents a summary of our debt and other major contractual obligations as well as other major commercial commitments.

<i>September 30, 2007 (Canadian dollars in millions)</i>	Total	2007¹	2008/2009	20010/2011	After 2011
Contractual Obligations (due by year)					
Short-term note payable	161	161	-	-	-
Long-term debt – principal repayments	5,315	40	900	650	3,725
Long-term debt – interest payments	5,166	111	563	487	4,005
Inergi LP outsourcing agreement ²	419	28	195	181	15
Operating lease commitments	18	2	11	3	2
Total Contractual Obligations	11,079	342	1,669	1,321	7,747
Other Commercial Commitments (by year of expiry)					
Bank line ³	750	-	-	750	-
Letters of credit ⁴	97	96	1	-	-
Guarantees ¹	275	275	-	-	-
Pension ⁵	214	18	188	8	-
Total Other Commercial Commitments	1,336	389	189	758	-

¹ The amounts disclosed represent the balance due over the period October 1, 2007 to December 31, 2007.

² On March 1, 2002, Inergi LP began providing a range of services to us for a 10-year period, including information technology, customer care, supply chain and certain human resources and finance services.

³ As a backstop to our commercial paper program, we have a \$750 million revolving standby credit facility with a syndicate of banks which matures in August 2010.

⁴ We currently have bank letters of credit of \$93 million outstanding relating to retirement compensation arrangements. We have also provided prudential support to the IESO on behalf of our subsidiaries as required by the Market Rules, using parental guarantees up to a maximum of \$275 million. The maximum parental guarantee is expected to increase in November 2007 to \$325 million as a result of forecast power purchases and the November 1, 2007 change to our transmission rates. Although no letters of credit are currently required for prudential support, we would have to resume providing bank letters of credit if our highest long-term credit rating deteriorated to below the "Aa" category. The remaining amounts included in letters of credit pertain to operating letters of credit and to surety bonds.

⁵ Contributions to the pension fund are made one-month in arrears. Contributions for 2007 are based on an actuarial valuation filed in September 2007 and effective December 31, 2006. Our annual pension contributions for 2007 - 2009 will be about \$94 million. Contributions beyond 2009 will be based on an actuarial valuation effective December 31, 2009 and will depend on future investment returns, changes in benefits or actuarial assumptions. Pension contributions beyond 2009 are not estimable at this time.

The amounts in the above table under long-term debt are not charged to our results of operations, but are reflected on our balance sheet and statement of cash flows. Interest associated with this debt is recorded under financing charges on our statement of operations or in our capital programs, but these financing charges are not reflected in the above table. Payments in respect of operating leases and our outsourcing agreement with Inergi LP are recorded under operation, maintenance and administration costs on our statement of operations or in our capital programs.

RELATED PARTY TRANSACTIONS

Our related party transactions primarily consist of our transmission revenues received from, and our power purchases payments made to, the IESO, which is a related party by virtue of its status as an agency of our shareholder, the Province of Ontario. The year-over-year changes related to these amounts are described more fully in our discussion of transmission revenues and purchased power costs. Other significant related party transactions include our dividends which are paid to the Province of Ontario and our payments in lieu of corporate income taxes which are paid or payable to the Ontario Electricity Financial Corporation.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

RECENT DEVELOPMENTS

Transmission Rate Decision

On August 16, 2007, the OEB issued its decision in respect of our 2007 and 2008 transmission rate application. The decision, which is effective January 1, 2007, showed confidence in our work programs by approving all of our operating and capital expenditures for 2007 and 2008. The decision resulted in an estimated 8% annual reduction in transmission rates primarily due to a reduction in the approved return on equity from 9.88% to 8.35%, based on a formula used by the OEB in the regulation of local distribution companies. With the rate adjustment taking effect November 1, 2007, there is an estimated one-time reduction in transmission rates of about 13%, resulting in a reduction of approximately 1% on an average customer's total bill.

As part of a joint proceeding involving all Transmitters in Ontario, on October 17, 2007, the OEB approved new Ontario Uniform Transmission Rates for implementation on November 1, 2007 noting that these Uniform Transmission Rates will be in effect until December 31, 2008.

IPSP

On August 29, 2007, the OPA submitted its application to the OEB for review and approval of the IPSP for Ontario. The plan's estimated 20-year, \$60-billion capital cost will be directed toward initiatives required to deliver electricity to Ontario consumers. The IPSP focused on the medium to long term, recommending that project development work on certain major transmission projects, including generation enabling connection lines and projects addressing reliability of local area supply, commence once the IPSP is approved. OEB approval is expected in the Fall of 2008. Any development work commencing until at least the next IPSP is submitted, will continue to require us to prove project need as part of our section 92 leave-to-construct proceedings.

Decision on Combined Transmission Connection Procedures Proceeding

On September 6, 2007, the OEB issued its decision related to our August 20, 2006 application for transmission connection procedures. The OEB noted that the connection procedures that we filed drew no substantial criticism or comment from intervening parties or OEB staff as evidence of our commitment to a fair, transparent and effective connection process. The OEB's decision, however, was inconsistent with our position on the need for capital contributions for Local Area Supply facilities. The OEB determined that capital contributions should generally be required. On October 9, 2007, we filed a motion to request a review of parts the decision.

Applications to Construct Facilities

On August 20, 2007, the OEB issued its decision granting us early access to lands expected to be used in the proposed Bruce to Milton transmission line project so we could conduct certain survey, testing, appraisal and investigative activities. The interim order, which is effective through to April 1, 2009, is subject to conditions that establish the parameters by which we are to conduct our work in order to ensure minimal disruption to landowners. We commenced early access activities in September.

On October 9, 2007 and October 11, 2007, the OEB issued two decisions approving our leave-to-construct applications for electricity transmission facilities in the western Brampton and Woodstock areas, respectively. These facilities are required to maintain reliability and improve system performance.

2008 Distribution Rate Applications

On August 15, 2007, we filed the revenue requirement component of our cost of service application with the OEB for our distribution business operated through Hydro One Networks. The cost allocation and rate design components of our application is expected to be filed later in the year. Our proposed revenue requirement for 2008 results in a net distribution rate increase of about 4%. This translates into an average annual increase on total customer bills of less than 2%.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

On September 28, 2007, the OEB issued its filing requirements for 2008 Incentive Regulation Mechanism applications to set distribution rates effective May 1, 2008 for all electricity distributors not filing a cost of service application. Our subsidiary Hydro One Brampton Networks filed its application with the OEB on November 1, 2007.

Distribution System Acquisition

On October 10, 2007, the OEB issued its decision approving our acquisition of the distribution system assets of Terrace Bay Superior Wires Inc. The acquisition closed on October 25, 2007.

OEB RPP Price Change

On October 12, 2007, the OEB announced a scheduled change in electricity prices for RPP customers. Beginning November 1, 2007, the electricity price has been reduced from 5.3 cents to 5.0 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.2 cents to 5.9 cents for kilowatt hours exceeding the thresholds.

Debt Issue

On October 18, 2007, we issued \$300 million of 10-year notes under our Medium-Term Note Program at a coupon rate of 5.18% and with a maturity date of October 18, 2017. The proceeds of the issue were temporarily invested in money market instruments, including asset backed commercial paper sponsored by the five major Canadian chartered banks. We do not hold any non-bank or third party sponsored commercial paper.

SELECTED FINANCIAL HIGHLIGHTS AND RATIOS

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
<i>(Canadian dollars in millions) (except as otherwise noted)</i>				
Net income	67	103	309	354
Net cash from operating activities	331	351	868	715
Capital expenditures	275	218	765	593
Earnings per common share <i>(Canadian dollars)</i>	618	991	2,952	3,407
Earnings coverage ratio ¹			2.68	2.66
Net asset coverage on long-term debt ²			1.92	1.92
Total debt to capitalization ³			52%	52%

¹The earnings coverage ratio has been presented for the twelve months ended September 30, 2007 and September 30, 2006, respectively and has been calculated as the sum of net income, provision for payments in lieu of corporate income taxes and financing charges divided by the sum of financing charges, capitalized interest and cumulative preferred dividends.

²The net asset coverage on long-term debt ratio has been presented as at September 30, 2007 and December 31, 2006 and has been calculated as total assets minus total liabilities excluding long-term debt (including current portion) divided by long-term debt including current portion.

³Total debt to capitalization ratio has been presented as at September 30, 2007 and December 31, 2006 and has been calculated as total debt divided by total debt plus total shareholder's equity.

FORWARD-LOOKING STATEMENTS AND INFORMATION

Our oral and written public communications, including this Management's Discussion and Analysis, often contain forward looking statements that are based on current expectations, estimates, forecasts and projections about our business and the industry in which we operate and include beliefs and assumptions made by the management of our company. Such statements include, but are not limited to statements regarding future capital expenditures; statements about the installation and cost of smart meters; expectations surrounding future pension contributions; statements regarding potential incremental environmental expenditures; and expectations concerning the impact of new accounting standards. Words such as "expect," "anticipate," "intend," "attempt," "may," "plan," "will," "believe," "seek," "estimate," and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. We do not

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

intend, and we disclaim any obligation to update any forward looking statements, whether written or oral, or whether as a result of new information, future events or otherwise, except as required by law.

These forward looking statements are based on a variety of factors and assumptions including, but not limited to the following: no unforeseen changes in the legislative and operating framework for Ontario's electricity market; favourable decisions from the OEB and other regulatory bodies concerning outstanding rate and other applications; and no significant events occurring outside the ordinary course of business. These assumptions are based on information currently available to us, including information obtained from third-party industry analysts. Actual results may differ materially from those predicted by such forward-looking statements. While we do not know what impact any of these differences may have, our business, results of operations, financial condition and our credit stability may be materially adversely affected. Factors that could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking statements include, among other things:

- the content of the final IPSP, once it is approved by the OEB;
- delays or denials of the requisite approvals for planned future capital expenditures;
- regulatory decisions regarding our revenue requirements and tariff rates;
- significant changes to Environment Canada's draft polychlorinated biphenyl (PCB) regulations issued on November 4, 2006; and
- future interest rates, inflation, changes in benefits and changes in actuarial assumptions.

We caution the reader that the above list of factors is not exhaustive.

This management's discussion and analysis is dated as at November 8, 2007. Additional information about our company, including our annual information form, is available on SEDAR at www.sedar.com.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

<i>(Canadian dollars in millions)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Revenues				
Transmission (Note 3)	307	331	949	945
Distribution (Note 4)	813	828	2,555	2,441
Other	8	6	22	17
	1,128	1,165	3,526	3,403
Costs				
Purchased power	533	564	1,696	1,667
Operation, maintenance and administration (Note 4)	263	233	756	652
Depreciation and amortization (Note 2)	128	132	382	377
	924	929	2,834	2,696
Income before financing charges and provision for payments in lieu of corporate income taxes	204	236	692	707
Financing charges	76	74	223	220
Income before provision for payments in lieu of corporate income taxes	128	162	469	487
Provision for payments in lieu of corporate income taxes	61	59	160	133
Net income	67	103	309	354
Other comprehensive income	(1)	-	-	-
Comprehensive income (Note 2)	66	103	309	354
Basic and fully diluted earnings per common share (Canadian dollars)	618	991	2,952	3,407

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (unaudited)

<i>(Canadian dollars in millions)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Retained earnings, beginning of period	1,246	1,107	1,184	1,079
Net income	67	103	309	354
Dividends (Note 5)	(72)	(63)	(252)	(286)
Retained earnings, end of period	1,241	1,147	1,241	1,147

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS (unaudited)

<i>(Canadian dollars in millions)</i>	September 30, 2007	December 31, 2006
Assets		
Current assets		
Accounts receivable (net of allowance for doubtful accounts)	748	777
Materials and supplies	64	56
Other	12	13
	824	846
Fixed assets		
Fixed assets in service	16,358	16,238
Less: accumulated depreciation	6,121	6,180
	10,237	10,058
Construction in progress	764	468
	11,001	10,526
Long-term assets		
Deferred pension asset	382	382
Regulatory assets	238	311
Goodwill	133	133
Long-term accounts receivable and other assets	7	12
	760	838
Total assets	12,585	12,210
Liabilities		
Current liabilities		
Bank indebtedness	15	29
Accounts payable and accrued charges	674	661
Accrued interest	86	49
Regulatory liabilities (Note 3)	102	-
Short-term notes payable	160	60
Long-term debt payable within one year (Note 6)	540	395
	1,577	1,194
Long-term debt (Note 6)	4,764	4,848
Other long-term liabilities		
Regulatory liabilities (Note 3)	468	473
Employee future benefits other than pension (Note 7)	848	803
Environmental liabilities	48	55
Long-term accounts payable and other liabilities	14	16
	1,378	1,347
Total liabilities	7,719	7,389
Shareholder's equity		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,314	3,314
Retained earnings	1,241	1,184
Accumulated other comprehensive income (Note 2)	(12)	-
Total shareholder's equity	4,866	4,821
Total liabilities and shareholder's equity	12,585	12,210

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Three months ended September 30		Nine months ended September 30	
<i>(Canadian dollars in millions)</i>	2007	2006	2007	2006
Operating activities				
Net income	67	103	309	354
Adjustments for non-cash items:				
Depreciation and amortization (net of removal costs)	119	120	350	347
Revenue difference deferral account <i>(Note 3)</i>	76	-	76	-
Retail settlement variance accounts	8	(5)	24	1
Disposition of deferral accounts <i>(Note 3)</i>	(28)	-	(28)	-
Transmission earnings sharing	-	6	-	24
Amortization of discount	-	5	6	23
Low-voltage services	-	-	-	(8)
	242	229	737	741
Changes in non-cash balances related to operations	89	122	131	(26)
Net cash from operating activities	331	351	868	715
Financing activities				
Long-term debt issued	-	150	400	700
Long-term debt retired	(73)	-	(355)	(448)
Short-term notes payable	85	(130)	100	-
Dividends paid	(72)	(63)	(252)	(286)
Other	-	-	(1)	(4)
Net cash used in financing activities	(60)	(43)	(108)	(38)
Investing activities				
Fixed assets	(275)	(218)	(765)	(593)
Other assets	4	4	19	13
Net cash used in investing activities	(271)	(214)	(746)	(580)
Net change in cash and cash equivalents	-	94	14	97
Cash and cash equivalents, beginning of period	(15)	(6)	(29)	(9)
Cash and cash equivalents, end of period	(15)	88	(15)	88

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. BASIS OF PRESENTATION

These interim Consolidated Financial Statements do not conform in all respects to the disclosure requirements of Canadian generally accepted accounting principles for annual financial statements and should, therefore, be read in conjunction with the annual Consolidated Financial Statements of Hydro One Inc. (Hydro One or the Company) for the year ending December 31, 2006 which includes information necessary or useful to understanding the Company's business and financial statement presentation. In particular, the Company's significant accounting policies and practices are presented as Note 2 to the annual Consolidated Financial Statements, and have been consistently applied in the preparation of these interim Consolidated Financial Statements, except as described below in Note 2.

The demand for electricity generally follows normal weather-related variations, and therefore the Company's energy-related revenues, all other things being equal, will tend to be higher in the first and third quarters than in the second and fourth quarters.

2. ACCOUNTING CHANGES

Change in Accounting Policy – Financial Instruments, Hedges and Comprehensive Income

Effective January 1, 2007, the Company adopted four new accounting standards comprising the Canadian Institute of Chartered Accountants' (CICA) Handbook Sections 1530, *Comprehensive Income*; 3855, *Financial Instruments – Recognition and Measurement*; 3861, *Financial Instruments – Disclosure and Presentation*; and 3865, *Hedges*. The adoption of these new standards required changes in the accounting for financial instruments and hedges, and the recognition of certain transition adjustments that are recorded in opening accumulated other comprehensive income (AOCI) as described below, consistent with the CICA Handbook sections. The comparative interim Consolidated Financial Statements have not been restated. The principal changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described below.

(a) Comprehensive Income

Comprehensive income is composed of the Company's net income and other comprehensive income (OCI). OCI includes the amortization of unamortized hedging losses on cash flow hedges that had been discontinued prior to the transition date. The impact of this amortization is immaterial to the Statement of Operations.

(b) Financial Assets and Liabilities

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity investments, loans and receivables, held-for-trading, other liabilities or available-for-sale. All financial instruments, including derivatives, are carried at fair value on the consolidated balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in financing charges in the period which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired. The Company has classified its financial instruments as follows:

Short-term investments	Held-to-maturity
Long-term accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Short-term notes payable	Other liabilities
Long-term debt (excluding MTN Series 8 Note)	Other liabilities
MTN Series 8 Note	Designated as held-for-trading

The MTN Series 8 Note is a step-up coupon note with extendable maturity dates up to 2011.

Where there is an economic hedge, as in the case of the MTN Series 8 note and associated interest rate swap, we have applied the fair value option without hedge accounting. The impact is not material.

All financial instrument transactions are recorded at trade date.

HYDRO ONE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

(c) Derivatives and Hedge Accounting

Derivatives

All derivative instruments, including embedded derivatives, are carried at fair value on the balance sheet unless exempted from derivative treatment as a normal purchase and sale. All changes in fair value are recorded in financing charges unless cash flow hedge accounting is used, in which case changes in fair value are recorded in OCI to the extent that the hedge is effective. The impact of the change in the accounting policy related to embedded derivatives was not material.

Hedge Accounting

The Company periodically develops hedging strategies for execution taking into account risk management objectives. At the inception of a hedging relationship, the Company documents the relationship between the hedging instrument and the hedged item. This would include linking all derivatives to specific assets and liabilities on the consolidated balance sheet or to specific firm commitments or forecasted transactions. The Company would also assess, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used are effective in offsetting changes in fair values or cash flows of hedged items.

Upon adoption of the new standards, the Company reclassified unamortized hedging losses on cash flow hedges that had been discontinued prior to the transition date to accumulated other comprehensive income. The hedging losses are amortized through OCI using the effective interest method over the term of the hedged debt.

(d) Transaction Costs

Transaction costs for financial assets and liabilities that are other than held-for-trading, are added to the carrying value of the asset or liability and then amortized over the expected life of the instrument using the effective interest method. The impact of the change in amortization method from an annuity basis to the effective interest method was not material.

Change in Accounting Estimate – Depreciation

Effective January 1, 2007, the Company prospectively revised its fixed asset depreciation rates resulting from a periodic external review required by the Ontario Energy Board (OEB). Capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment, which is depreciated on a declining balance basis. The estimated impact of the change in rates is a reduction in depreciation expense of approximately \$7 million per annum. A summary of the new rates for the various classes of assets is included below:

	Depreciation rates (%)	
	Range	Average
Transmission	1% - 4%	2%
Distribution	1% - 13%	2%
Communication	1% - 13%	5%
Administration and service	1% - 20%	8%

3. TRANSMISSION RATE DECISION

On August 16, 2007, the OEB issued its decision on the Transmission rate application made by the Company's subsidiary, Hydro One Networks Inc. The OEB decision is effective January 1, 2007 with resultant rates being implemented on November 1, 2007. On the basis of written and oral evidence submitted, the OEB approved substantially all of the Company's proposed capital and non-capital work programs, as well as a targeted rate of return on deemed common equity of 8.35% for the Company's Transmission business for the rate years 2007 and 2008. Previously, the approved rate of return was 9.88% on deemed common equity and was set in 1999. With this reduction in the rate of return, the OEB decision will result in a reduction in revenue over the remainder of 2007 and in 2008. In addition, the Company's transmission revenues reflect the impacts of the OEB's August 16, 2007 transmission rate decision, which had the effect of reducing its quarterly and year-to-date revenues by about \$38 million. This reduction includes the revenue adjustment associated with recording a new regulatory liability, termed the Revenue Difference Deferral Account (RDDA), as well as other decision-related revenue adjustments related to the disposition of regulatory asset and liability accounts and the recording of export and wheeling fees revenue.

HYDRO ONE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

The OEB decision also resulted in an increase in the aggregate carrying value of the Company's regulatory assets and liabilities of approximately \$46 million, representing an increase in regulatory liabilities of \$60 million and an increase in regulatory assets of \$14 million. The RDDA liability was approved in concept in the OEB's March 30, 2007 decision that terminated the Transmission Earnings Sharing Mechanism (ESM) effective December 31, 2006. In its August decision, the OEB approved final amounts and disposition treatments for the RDDA liability, the ESM liability, the export and wheeling fees liability, and a new Transmission market ready regulatory asset. The RDDA and ESM will be returned to customers over the two-year period ending December 31, 2008, while the export and wheeling fees liability and Transmission market ready regulatory asset will be factored into rates over the four-year period ending December 31, 2010. In the absence of rate regulated accounting, year-to-date operation, maintenance and administration expense would have been higher by approximately \$16 million and revenue would have been lower by approximately \$3 million.

4. SMART METER COST RECOVERY

On August 8, 2007, the OEB issued a decision on its combined proceeding to determine recoverability of expenditures incurred by distributors. Expenditures associated with the minimum functionality for advanced metering infrastructure incurred by the Company's subsidiaries Hydro One Networks Inc. and Hydro One Brampton Networks Inc. were approved for recovery. As a result of this decision, smart meter expenditures are no longer deferred as regulatory assets. Such expenditures are now classified as capital or are charged to results of operations consistent with the Company's standard accounting practices. Expenditures determined to be above the minimum functionality will be brought forward for review in a subsequent cost of service rate application.

The OEB decision also required that related revenues be based upon a calculated revenue requirement specific to smart meters. As a result, the carrying value of the smart meter regulatory asset account represents the difference between revenue recorded on this basis and actual recoveries received under existing rate adders. In the absence of rate regulated accounting, year-to-date operation, maintenance and administration expense would have been lower by approximately \$4 million.

5. DIVIDENDS

During the three months ended September 30, 2007, preferred dividends in the amount of \$4 million (2006 - \$4 million) and common dividends in the amount of \$68 million (2006 - \$59 million) were declared. During the nine months ended September 30, 2007, preferred dividends in the amount of \$13 million (2006 - \$13 million) and common dividends in the amount of \$239 million (2006 - \$273 million) were declared.

6. LONG-TERM DEBT

On March 13, 2007, Hydro One issued notes under the Company's medium term note program. The issue was comprised of medium term notes with a principal amount of \$400 million having a 30-year term with a coupon rate of 4.89%. The notes are due March 13, 2037.

In the second quarter, Hydro One extended the maturity date of its \$40 million extendible step-up note from May 15, 2007 to November 15, 2007. On October 17, 2007, the maturity date of the note was extended again to May 15, 2008 with a new coupon rate of 4.70% per annum.

The Company has a \$750 million, revolving standby credit facility with a syndicate of banks. The term of this facility has been extended as of August 10, 2007 to August 10, 2010.

In the third quarter, the Company entered into two forward starting pay fixed interest rate swap agreements to hedge against the effect of future interest rate movements on long-term fixed rate borrowing requirements. The transactions, with notional amounts of \$150 million and \$50 million respectively, are used to fix the interest rate of a forecasted debt issuance planned for later in 2007 and are being accounted for as cash flow hedges of a forecasted transaction.

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

7. EMPLOYEE FUTURE BENEFITS

Total benefit costs are as follows:

<i>(Canadian dollars in millions)</i>	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Pension				
Net periodic benefit cost	26	38	76	116
Pension fund contribution	25	22	76	66
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	10	8	30	25
Portion attributable to regulatory assets	-	-	-	11
Charged to results of operations	15	14	46	30
Employee Future Benefits Other than Pension				
Net periodic benefit cost	27	30	80	91
Less: Portion attributable to labour and capitalized as part of the cost of fixed assets	10	10	31	29
Charged to results of operations	17	20	49	62

8. SEGMENTED REPORTING

Hydro One has three reportable segments:

- The transmission business, which comprises the core business of providing transportation and connection services, is responsible for transmitting electricity throughout the Ontario electricity grid;
- The distribution business, which comprises the core business of delivering and selling electricity to customers; and
- An "other" segment primarily consisting of telecommunications business.

The designation of segments has been based on a combination of regulatory status and the nature of the products and services provided. Segment information on the above basis is as follows:

<i>Three months ended September 30 (Canadian dollars in millions)</i>	Transmission	Distribution	Other	Consolidated
2007				
Segment profit				
Revenues	307	813	8	1,128
Purchased power	-	533	-	533
Operation, maintenance and administration	117	137	9	263
Depreciation and amortization	56	71	1	128
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	134	72	(2)	204
Financing charges				76
Income before provision for payments in lieu of corporate income taxes				128
Capital expenditures	144	126	5	275

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

Three months ended September 30 (Canadian dollars in millions)

	Transmission	Distribution	Other	Consolidated
2006				
Segment profit				
Revenues	331	828	6	1,165
Purchased power	-	564	-	564
Operation, maintenance and administration	105	122	6	233
Depreciation and amortization	64	67	1	132
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	162	75	(1)	236
Financing charges				74
Income before provision for payments in lieu of corporate income taxes				162
Capital expenditures	93	123	2	218

Nine months ended September 30 (Canadian dollars in millions)

	Transmission	Distribution	Other	Consolidated
2007				
Segment profit				
Revenues	949	2,555	2	3,526
Purchased power	-	1,696	-	1,696
Operation, maintenance and administration	323	410	23	756
Depreciation and amortization	176	202	4	382
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	450	247	(5)	692
Financing charges				223
Income before provision for payments in lieu of corporate income taxes				469
Capital expenditures	394	355	16	765

2006				
Segment profit				
Revenues	945	2,441	17	3,403
Purchased power	-	1,667	-	1,667
Operation, maintenance and administration	307	328	17	652
Depreciation and amortization	184	189	4	377
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	454	257	(4)	707
Financing charges				220
Income before provision for payments in lieu of corporate income taxes				487
Capital expenditures	290	298	5	593

(Canadian dollars in millions)

	September 30, 2007	December 31, 2006
Total assets		
Transmission	7,180	6,950
Distribution	5,304	5,161
Other	101	99
	12,585	12,210

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

9. COMMITMENTS

Purchasers of electricity in Ontario, through the Independent Electricity System Operator (IESO), are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees should the Company's subsidiaries, Hydro One Networks Inc. or Hydro One Brampton Networks Inc., fail to make a payment required by a default notice issued by the IESO.

On June 28, 2007, the IESO approved revisions to the prudential support obligations under the market rules. Previously, prudential support was provided to the IESO using a combination of bank letters of credit and parental guarantees. Under the new rules, effective August 1, 2007 the Company can meet its prudential support requirements using only parental guarantees, as long as it maintains a long-term credit rating in the "Aa" category. Consequently, the Company has reduced its bank letters of credit by \$10 million, having met the credit rating criteria.

10. SUBSEQUENT EVENTS

On October 12, 2007, the OEB announced a decrease in electricity prices for Regulated Price Plan customers. Beginning November 1, 2007, the electricity price has been reduced from 5.3 cents to 5.0 cents per kilowatt hour for customers consuming up to certain thresholds, depending on the type of customer, and from 6.2 cents to 5.9 cents for kilowatt hours exceeding the thresholds.

On October 18, 2007, Hydro One issued notes under the Company's medium term note program. The issue was comprised of medium term notes with a principal amount of \$300 million having a 10-year term with a coupon rate of 5.18%. The notes are due on October 18, 2017. In relation to this debt issuance, the Company terminated on October 18, 2007 the two forward starting pay fixed interest rate swaps entered into on August 2, 2007 and September 10, 2007. The transactions had been accounted for as cash flow hedges of a forecasted debt issue for the purpose of fixing the interest rate for the debt issuance. The net gain realized on terminating the swaps was \$0.4 million.

11. COMPARATIVE FIGURES

The comparative unaudited interim Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the September 30, 2007 unaudited interim Consolidated Financial Statements.